

Internal Financial Control - Key Factors for Successful Implementation

October 18, 2014

Agenda

1. Companies Act Requirements and IFC
2. Overall process
3. Key success factors

Companies Act Requirements on IFC

Companies Act 2013 – Internal Financial Controls Requirements

Evaluation of internal financial controls by Audit Committee

Clause 177 (4)(vii)

Every **Audit Committee** shall act in accordance with the terms of reference specified in writing by the Board which shall inter alia and include **evaluation of internal financial controls** and risk management systems.

Integrity of financial statements to be validated by independent directors

Schedule IV (II)(4):

Independent Directors shall satisfy themselves on the **integrity** of financial information and that of financial controls.

BoD to ensure implementation of adequate internal financial controls

Clause 134 (5)(e)

The **report** by the **Board of Directors (BoD)** shall include a statement ensuring **implementation** of adequate **internal financial control** and adherence of policy and procedures adopted by the company with an objective of orderly and efficient conduct of its business, safeguarding company's assets, prevention and detection of frauds, for accuracy and completeness of the accounting records and timely preparation of reliable financial information.

Auditor's report to state adequacy and effectiveness of controls

Clause 143 (3)(i)

Auditor's report should state the **adequacy and operating effectiveness** of the Company's internal financial controls.

Consequences of Non Compliance

Consequences of non compliances with the required provisions

- As per section 134 (8) If a company **contravenes** the provisions of this section, the company shall be punishable with fine which shall not be less than fifty thousand rupees but which may extend to twenty-five lakh rupees and **every officer of the company who is in default** shall be punishable with **imprisonment** for a term which may extend to **three years** or with fine which shall not be less than fifty thousand rupees but which may extend to five lakh rupees, or with both.

Definition of Internal Financial Controls

- **Meaning of IFC provided in the explanation to Sec 134(5)(e) of the Companies Act, 2013**

- For purpose of this section, “internal financial controls” means the policies and procedures adopted by the company for ensuring the **orderly and efficient conduct of its business**, including adherence to company’s policies, the safeguarding of its assets, the prevention and detection of frauds and errors, the **accuracy** and completeness of the accounting records, and the timely preparation of reliable financial information.

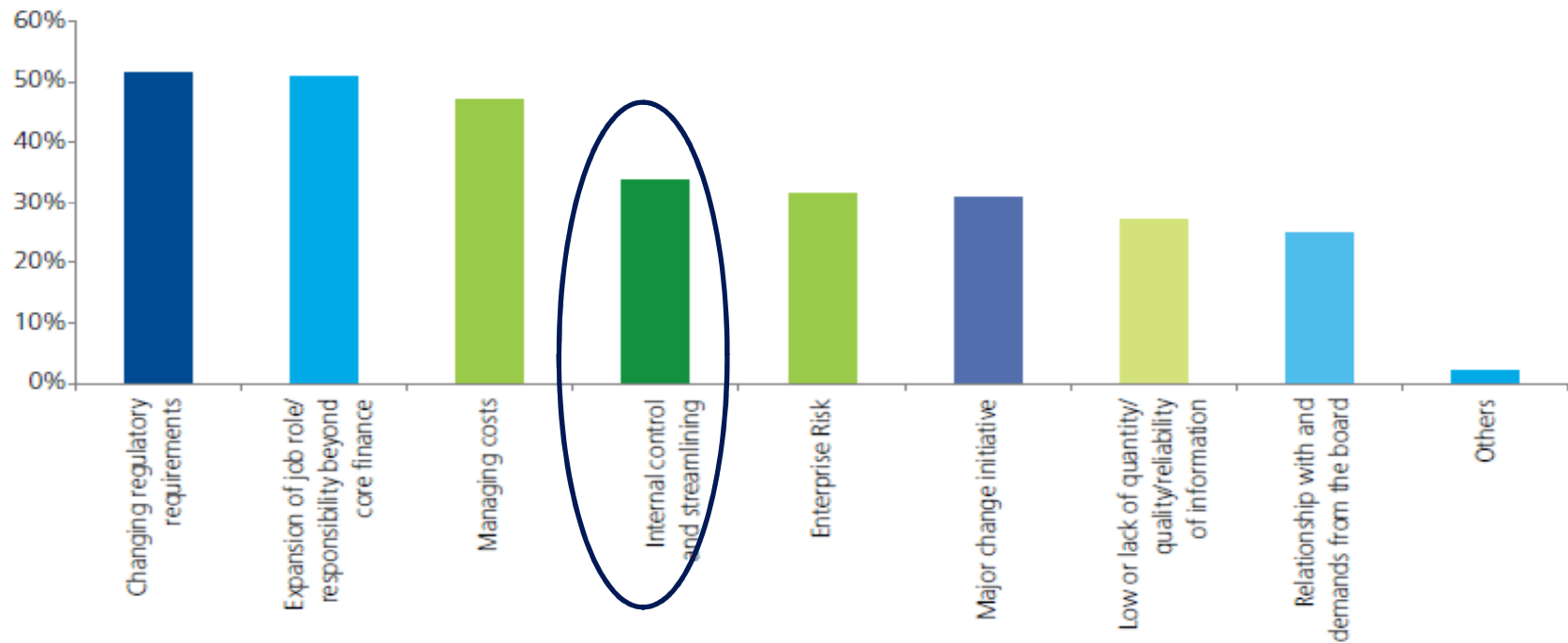
- **Definition of Internal Control as per (“COSO”)**

- Internal control is a process, effected by an entity’s board of directors, management, and other personnel, designed to provide **reasonable assurance** regarding the achievement of objectives relating to operations, reporting, and compliance

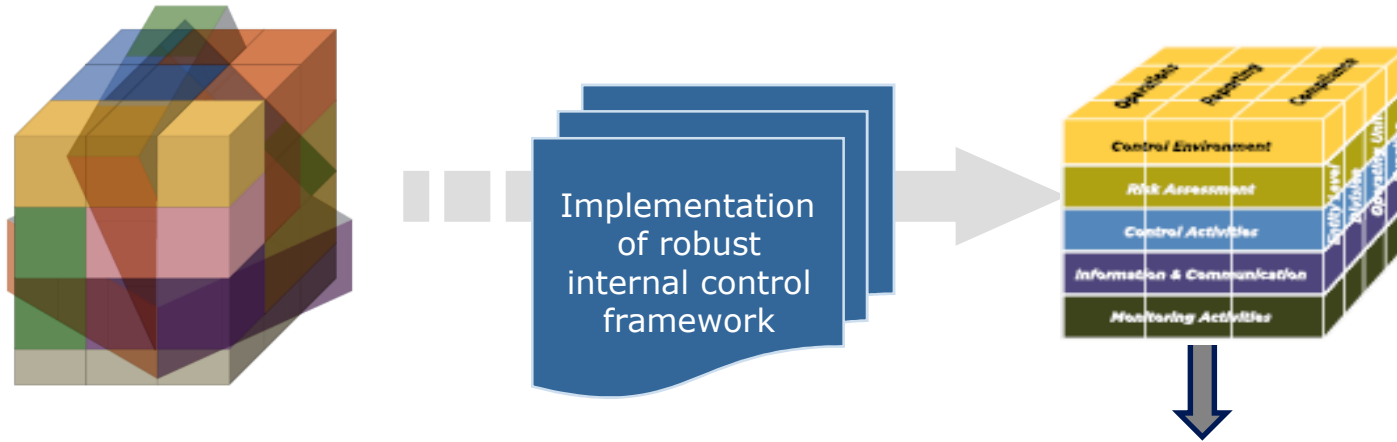
Why do we need internal financial controls

As per latest Deloitte CFO survey, internal control and streamlining has been identified as one of the major concerns

CFOs Concern



Benefits of internal Controls



Key benefits of internal controls :

- Ensures **reliable financial reporting** and improves overall confidence on reported numbers to various stakeholders.
- Helps in **achievement of desired objectives** on financial, operational and compliance side.
- Exhibits **better governance** standards of an organization.
- Help **prevent errors and irregularities** from occurring. If errors or irregularities do occur, internal controls will help ensure they are detected in a timely manner.
- Encourage **adherence** to prescribed **policies and procedures**.
- Brings in **efficiencies** in operations.

Overall Process

What is Internal Control

Under the COSO Internal Control-Integrated Framework, internal control is broadly defined as a process, effected by an entity's board of directors, management, and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

- 1 Effectiveness and efficiency of operations**
- 2 Reliability of financial reporting**
- 3 Compliance with laws and regulations**

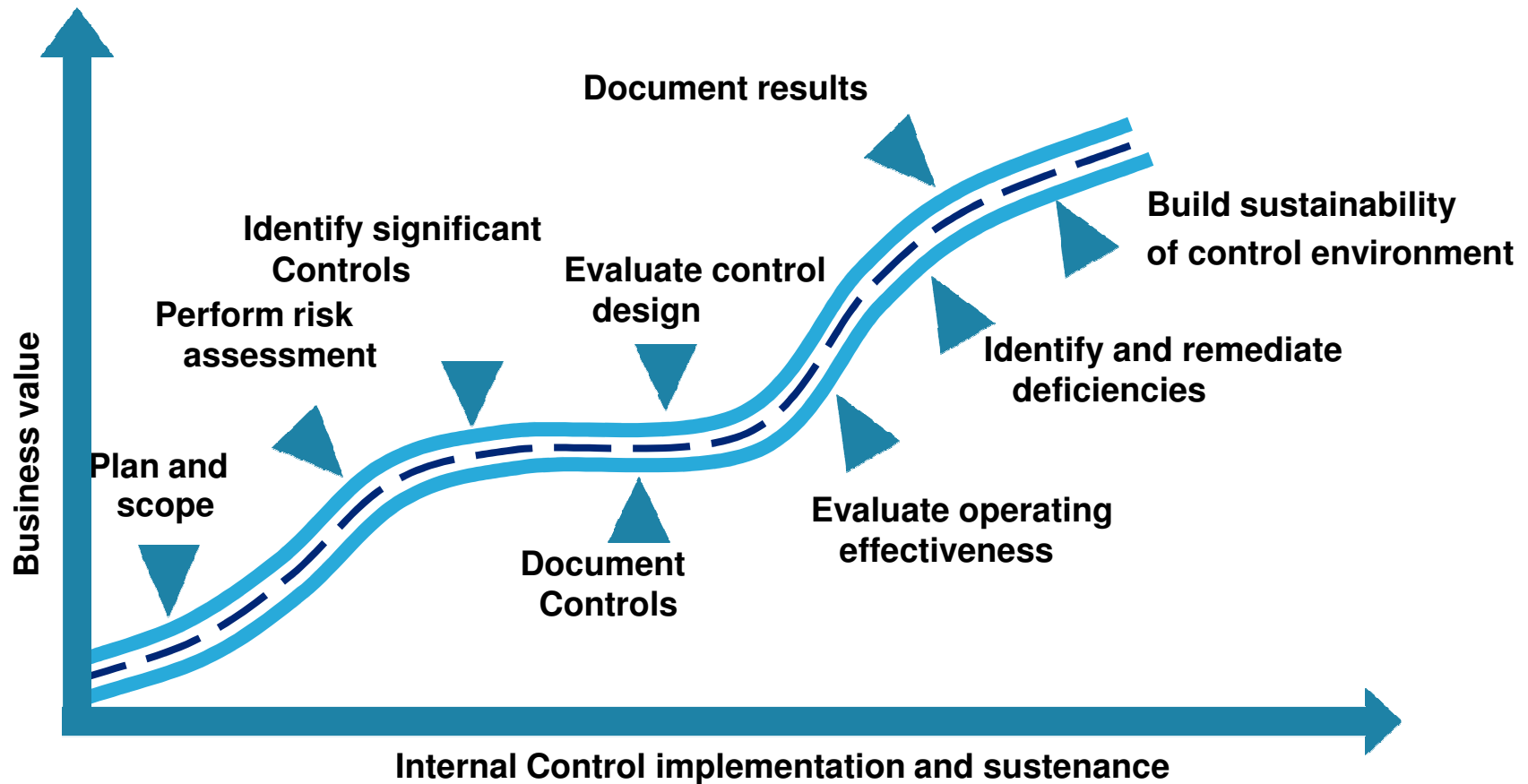
COSO Framework

- The 2013 Framework:
 - Creates a more formal structure for the design and evaluation of the effectiveness of internal control
 - Adds and refreshes guidance within each of the components of internal control



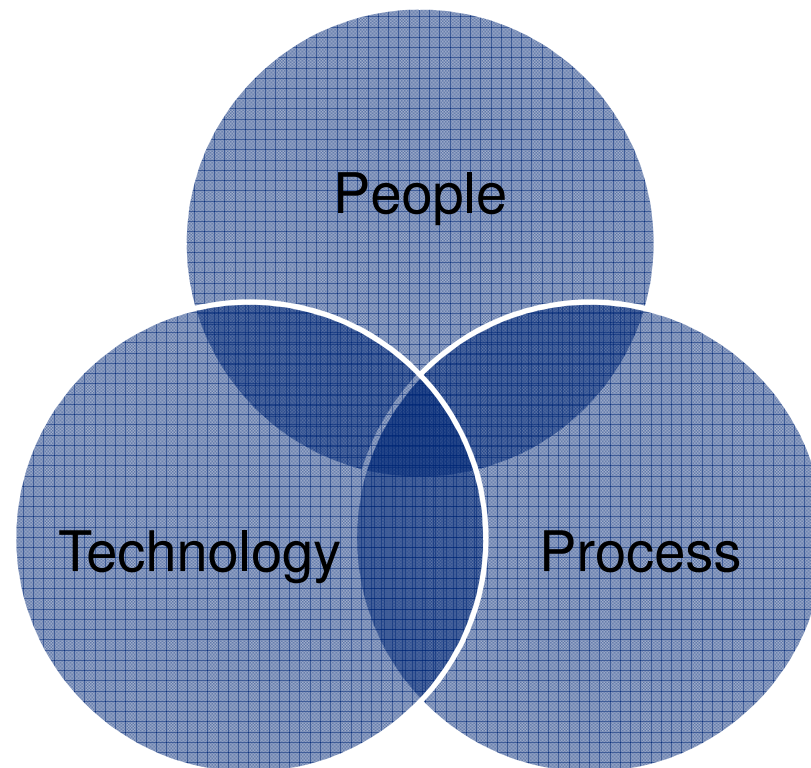
Internal Financial Controls Journey

The following is the typical risk-based internal controls journey:



Key success factors...1

Year one is crucial from an internal control framework implementation perspective. The following are some the important considerations which have to be kept in mind to get the desired success in implementation and continued sustenance of a robust internal control environment



Key success factors...People Aspects

- Involvement of Board and audit committee from the beginning
- Ensure the right team is involved
 - Knowledge of the Business process
 - Knowledge on Internal Controls
 - Knowledge of IT Environment and application controls
- Adequate Monitoring, oversight, transparency and continuous training and development of concerned stakeholders will ensure continued sustenance of a robust internal control environment

Key success factors.. Process

- Establishing a governance framework for implementing, managing and monitoring internal controls including Entity level controls
- Right scoping of the processes and applications based on the materiality.
- Formalization of policies, standard operating procedures, workflows & authority matrix
- Maker – checker control / 4 eye principle

Adequate Monitoring, oversight, transparency and continuous training and development of concerned stakeholders will ensure continued sustenance of a robust internal control environment....

Key success factors.. Technology

- Segregation of duties and access controls, automation of controls through ERP.
- Redeployment of work routines to enable audit trails, evidencing the reviews etc.
- Ensuring Reports generated from the applications (IPE) are tested adequately
- Choice of right tools for implementation depending on scale of operations.

References

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